Before the
Federal Communications Commission
Washington, DC 20554

In the Matter of	)	
	)	
Developing a Unified Intercarrier Compensation Regime	)	CC Docket No. 01-92
	)	

REPLY COMMENTS OF TDS

Gerard J. Waldron
Mary Newcomer Williams
Darrin Hurwitz
COVINGTON & BURLING
1201 Pennsylvania Avenue, N.W.
Washington, D.C. 20004-2401
Tel.: (202) 662-6000
Fax: (202) 662-6291

Kathleen Wallman
KATHLEEN WALLMAN, PLLC
9332 Ramey Lane
Great Falls, VA 22066

Counsel to TDS Telecommunications Corp.

July 20, 2005

SUMMARY

The comments filed in response to the Commissions' *Further Notice of Proposed Rulemaking* in this proceeding support three key conclusions:

(1) There is widespread opposition – from industry, state regulators, and consumer advocates – to adoption of a mandatory "bill-and-keep" system under which most intercarrier compensation is eliminated and carriers recover all network costs from end-users.

(2) This opposition stems from a well-reasoned conclusion that a mandatory bill-and-keep system would not be economically efficient; would not be easy to implement and administer (despite appearances to the contrary at first blush); and would not advance the Commission's other articulated goals for this proceeding.

(3) Intercarrier revenues play a key role in the Commission's over-arching goal of achieving "a rapid, efficient, Nation-wide . . . communication service with adequate facilities at reasonable charges."* The continued availability of intercarrier revenues will be essential to promoting advanced, broadband telecommunications services that are widely available and accessible to all Americans.

The comments do *not* justify or support any radical transformation of the intercarrier compensation system at this time. Instead, the Commission should focus its efforts on remedying immediate and specific intercarrier compensation issues. Initially, the Commission should take steps (1) to minimize phantom traffic; (2) to clarify carrier transiting obligations (including with respect to ISP-bound traffic); (3) to define financial responsibility for transport of Virtual NXX calls; (4) to address compensation obligations for IP-based calls terminating on the public switched network; and (5) to eliminate the intraMTA rule.

* *See* 47 U.S.C. § 151 (setting forth the broad purpose of the Federal Communications Commission).

To the extent that the Commission decides to pursue more fundamental intercarrier compensation reforms, TDS supports the collaborative framework proposed in the Rural Alliance comments and reply comments. It is particularly critical that any new intercarrier compensation regime satisfy the following requirements: (1) establish a system that enables each carrier to transition towards a unified rate for all traffic, while allowing rates to vary between carriers based on differences in their underlying cost structures; (2) preserve compensation for originating and terminating calls; and (3) include mechanisms to preserve carriers' incentives to invest in evolving telecommunications services, consistent with the goal of maintaining comparable services and rates between urban and rural areas. There is no need for the Commission to dramatically alter existing interconnection arrangements and obligations.

The approach supported by TDS will promote the public interest by remedying immediate and specific problems with the intercarrier compensation system and ensuring that carriers throughout the country continue to have the financial wherewithal to provide high-quality, advanced telecommunications services connecting consumers nationwide.

TABLE OF CONTENTS

Before the
Federal Communications Commission
Washington, DC 20554

In the Matter of	)	
	)	
Developing a Unified Intercarrier Compensation Regime	)	CC Docket No. 01-92
	)	

REPLY COMMENTS OF TDS

The more than one hundred comments filed in response to the Commission's *Further Notice of Proposed Rulemaking* (*Further Notice*) in this proceeding reflect a broad diversity of opinion about the best approach to reforming the intercarrier compensation system. Among this diversity of perspectives, however, a few general themes emerge. *First*, there is no broad consensus around any specific proposal to alter the fundamentals of the existing intercarrier compensation system. *Second*, a significant majority of commenters, including state regulators, consumer advocates, and carriers from various industry segments, raise grave concerns in opposition to the adoption of any mandatory "bill-and-keep" system to replace existing intercarrier compensation mechanisms. These concerns stem from a well-reasoned conclusion that a mandatory bill-and-keep system would not be economically efficient; would not be easy to implement and administer; and would not advance the Commission's other articulated goals for this proceeding. *Third*, it is clear that, for many carriers across the industry, intercarrier revenues play a key role in sustaining "a rapid, efficient, Nation-wide . . . communication service with adequate facilities at reasonable charges."[1] The ongoing availability

[1] The Commission's overriding goal under the Communications Act is "to make available, so far as possible, to all the people of the United States, without discrimination . . ., a rapid, efficient, Nation-wide and world-wide wire and radio communication service with adequate facilities at reasonable changes . . ." 47 U.S.C. § 151. More specifically, Chairman Martin has identified the nationwide deployment of advanced telecommunications services as the Commission's "No. 1 priority" at this time. *See* Drew
(continued…)

of this revenue source will be essential to promoting advanced, broadband telecommunications services that are widely available and accessible to all Americans.

In general, the comments evidence a widely (albeit not universally) held belief that a mandatory bill-and-keep system will not accomplish the Commission's goals of promoting efficient investment and competition, preserving universal service, and ensuring competitive and technological neutrality in intercarrier compensation. Put simply, the comments do not provide the type of evidentiary record that would justify radically overhauling the intercarrier compensation system to pursue largely speculative benefits. Instead, the comments counsel in favor of a targeted, measured approach that will improve the efficiency and transparency of the intercarrier compensation system while preserving long-term revenue stability and balance among revenue sources.

TDS Telecommunications Corp. (TDS Telecom) and TDS Metrocom, Inc. (TDS Metrocom) (collectively, TDS) urge the Commission to focus its efforts in this proceeding on remedying immediate and specific problems with the existing intercarrier compensation system. Issues that are ripe for resolution in the near term include: (1) minimizing phantom traffic; (2) clarifying carrier transiting obligations (including with respect to ISP-bound traffic); (3) defining financial responsibility for transport of Virtual NXX calls; (4) addressing compensation obligations for IP-based calls terminating on the public switched network; and (5) eliminating the intraMTA rule.

(continued…)
Clark, "FCC Chief: Broadband is Top Priority," *National Journal's Technology Daily*, May 27, 2005; *see also* Kevin J. Martin, "United States of Broadband," *The Wall Street Journal* (Jul. 7, 2005) at A12 ("Creating a policy environment that speeds the deployment of broadband throughout the U.S. is my highest priority as the new chairman of the FCC.").

To the extent that the Commission decides to pursue more fundamental intercarrier compensation reforms, TDS supports the collaborative framework proposed in the Rural Alliance comments and reply comments. We urge the Commission to ensure that any new intercarrier compensation regime satisfy the following requirements: (1) establish a system that enables each carrier to charge a unified rate for all traffic, while allowing rates to vary between carriers based on differences in their underlying cost structures; (2) preserve compensation for originating and terminating calls; and (3) include mechanisms to preserve carriers' incentives to invest in evolving telecommunications services, consistent with the goal of maintaining comparable services and rates between urban and rural areas. Fundamentally, any intercarrier compensation system should ensure that all carriers – urban, suburban, and rural, incumbent and competitor – have adequate revenue and investment incentives to continue to provide high-quality, advanced telecommunications services connecting all consumers nationwide.

I. THE COMMENTS DO NOT SUPPORT RADICAL REFORM OF THE INTERCARRIER COMPENSATION SYSTEM

The comments in this proceeding reflect widespread disagreement on many critical issues in the intercarrier compensation debate, including whether recovery of network costs from end users or all users is more economically efficient,[2] whether network costs are traffic-sensitive or not,[3] and whether the Commission even has the legal authority to adopt a

---

[2] *Compare* Intercarrier Compensation Forum (ICF) Comments at 26 (carriers should recover from end users rather than uncertain regulations) *with* CenturyTel Comments at 19 (bill-and-keep, by shifting costs to end users, will discourage investment); Colorado Telecommunications Association *et al.* (CTA) Comments at 32 (cost recovery cannot depend on increasing end-user charges); Verizon Comments at 26-27 (Commission cannot assume that carriers will be able to increase charges to end users where other sources of compensation are reduced).

[3] *Compare* National Telecommunications Cooperative Association (NTCA) Comments at 36 (switching and transport are traffic sensitive); United States Telecom Association (USTA) Comments at 24 (switching costs are traffic sensitive); BellSouth Comments at 22-26 (switching costs are traffic sensitive)

(continued…)

unified intercarrier compensation regime.[4] Despite the passage of four years since the initial *NPRM* in this proceeding, there still remains nothing approaching common ground in support of a new approach to intercarrier compensation, nor any consensus that has built around any of the specific reform proposals that have been offered. There is no conclusive body of evidence in the record that any radical restructuring of the existing intercarrier compensation system is necessary to further the goals of the Communications Act and the public interest.

Indeed, there is every indication that now is not the time for the Commission to jettison the existing intercarrier compensation system and attempt to construct a workable alternative in the face of conflicting evidence about the best approach to intercarrier compensation reform. Under the existing intercarrier compensation system, consumers throughout the country have seen vibrant growth in a range of advanced telecommunications products and services, and commenters have offered no evidence refuting the role that intercarrier revenues have played in supporting this growth. Moreover, as the National Association of State Utility Consumer Advocates (NASUCA) has pointed out, "radical changes to the current [intercarrier compensation] regime are not advisable because the pace of technological and market change is so rapid that it would be folly to adopt a so-called 'ultimate solution' to [intercarrier compensation] at this time."[5] In the absence of any meaningful showing that immediate, structural intercarrier compensation reform is necessary to advance the

---

(continued…)
with CTIA-The Wireless Association™ (CTIA) Comments at 16 (network costs are not traffic sensitive). *See also* Rural Alliance Comments at 50-54.

[4] *Compare* BellSouth Comments at 39 (Commission has legal authority under § 201 to adopt unified regime); Time Warner Inc. (Time Warner) Comments at 7 (Communications Act provides broad jurisdiction) *with* National Association of Regulatory Utility Commissioners (NARUC) Comments at 5 (Commission has no authority over intrastate access); Verizon Comments at 33 (Commission's legal authority to adopt comprehensive intercarrier compensation reform is uncertain).

[5] National Association of State Utility Consumer Advocates (NASUCA) Comments at 2-3.

fundamental goals of the Communications Act – which must be the ultimate standard for taking regulatory action – the Commission should give great weight to the widely-expressed concern that radical changes in intercarrier compensation could significantly *undermine* the statutory goal by dismantling many of the incentives that drive investment in advanced telecommunications networks.

Against this backdrop, TDS urges the Commission to take a diagnostic approach to intercarrier compensation reform. Initial steps should focus on identifying and remedying real, immediate problems through targeted solutions. With respect to more structural intercarrier compensation reforms, TDS supports the measured, collaborative framework for reform outlined in the comments and reply comments of the Rural Alliance. TDS disagrees with the contention of the Intercarrier Compensation Forum (ICF) that proposals offered by rural carriers represent only a small number of customers nationwide and therefore should not dictate overall intercarrier compensation policy.[6] The ICF's position gives inadequate consideration to the statutory imperative dictating that telecommunications services be provided to all customers, including those in rural areas, at a level reasonably comparable to services provided to urban customers.[7] Moreover, adopting an intercarrier compensation system that is unworkable for rural carriers, and then exempting rural carriers from various aspects of the system, makes for an even more complex system than currently exists and is inconsistent with the Commission's goal of a competitively and technologically neutral intercarrier compensation system.[8]

---

[6] *See* ICF Comments at 51.

[7] 47 U.S.C. § 254(b)(3).

[8] *See* Further Notice of Proposed Rulemaking, *Developing a Unified Intercarrier Compensation Regime*, CC Docket No. 01-92, 20 FCC Rcd 4685, 4702 [¶ 33] (2005) (*Further Notice*).

II. MANDATORY BILL-AND-KEEP PROPOSALS WILL NOT ACCOMPLISH THE COMMISSION'S GOALS OR SERVE THE PUBLIC INTEREST

The most significant area of consensus that emerges from the comments is that proposals supporting a mandatory bill-and-keep system that would eliminate most intercarrier payments for the use of each others' networks – principally the ICF Plan and the CTIA and Western Wireless proposals – do not offer a viable, legal, or economically efficient alternative to the current intercarrier compensation system.

A. Commenters Raise Grave Concerns In Opposition to Mandatory Bill-and-Keep

Numerous commenters, including carriers from various industry segments as well as disinterested parties such as NASUCA, the National Association of Regulatory Utility Commissioners (NARUC), and other state regulators, are on the record opposing mandatory bill-and-keep proposals. For example, BellSouth asserts that "bill-and-keep would not promote economic efficiency or preserve universal service, nor is bill-and-keep competitively neutral."[9] Time Warner Telecom says that "[b]ill and keep is beset by legal problems that likely preclude its implementation for most, if not all, classes of traffic" and is not more efficient than cost-based unified rates.[10] CenturyTel expresses concern that bill-and-keep is not revenue neutral, will shift costs to end users, and will discourage investment.[11] NARUC states emphatically that "it is clear that [it] will not endorse any proposal that … *mandates* bill-and-keep," and that the Commission should instead design intercarrier compensation rates that recover carriers' network costs.[12] Similarly, NASUCA expresses concern that because, under mandatory bill-and-keep,

---

[9] BellSouth Comments at 9.
[10] Time Warner Telecom *et al.* (Time Warner Telecom) Comments at 19, 30-35.
[11] CenturyTel Comments at 19-20.
[12] NARUC Comments at 2-3.

"[intercarrier compensation] rates would no longer reflect the cost of using another carrier's network, normal cost-related usage incentives and disincentives are eliminated under the ICF [bill-and-keep] plan."[13] The Nebraska Public Service Commission opposes mandatory bill-and-keep, expressing concern that it "does not take into account many of the economic realities of rural carriers providing service in insular areas."[14] The Small Business Administration notes the negative impact of mandatory bill-and-keep on small and rural carriers and states that bill-and-keep should be optional, not mandatory, based on carriers' determination of whether bill-and-keep makes sense in a particular relationship.[15]

These critiques of bill-and-keep reflect but a few of the multitude of comments – from divergent interests – that express strong disapproval of transitioning to a mandatory bill-and-keep regime.[16] Who supports mandatory bill-and-keep? Left standing in support are a handful of incumbent local exchange carriers (ILECs), interexchange carriers (IXCs), and wireless carriers that will profit directly from the elimination of origination and termination charges in favor of direct billing of end users. These supporters do not show that the current system hinders service to customers or deters investment. Rather, supporters assert that they would be better off under mandatory bill-and-keep, while ignoring the views of state regulators,

---

[13] NASUCA Comments at 46.

[14] Nebraska Public Service Commission Comments at 7.

[15] Small Business Administration Comments at 7-9, 12.

[16] *See also, e.g.*, Iowa Telecommunications Association Comments at 4 (move to bill-and-keep would be catastrophic to smaller low-cost, high-density rural ILECs); South Dakota Public Service Commission Comments at 5 (imposition of bill-and-keep will harm rural telephone companies); TCA Comments at 7 ("[M]andatory imposition of [bill-and-keep] will prove devastating for many rural LECs and the customers they serve."); Texas Office of Public Utility Counsel, Consumer Federation of America and Consumers Union Comments at 10 ("[B]ill and keep will lead to the abuse of consumers because it will result in large increases in end user rates, especially in rural areas."); Wyoming Office of Consumer Advocate Comments at 6-7 (bill-and-keep not in public interest because would cause market distortion, create new arbitrage opportunities and offer disincentives for network investments).

consumer advocates, and large and small carriers who attest that most carriers and their customers would be worse off under such a system.

B. A Mandatory Bill-and-Keep System Would Not Promote Administrative or Economic Efficiency

The rationales offered by proponents of mandatory bill-and-keep are fraught with overstatements of the benefits and understatements of the risks of such an approach. For example, whereas its supporters contend that bill-and-keep offers a simple and efficient approach to intercarrier compensation reform,[17] the need for exceptions to accommodate disadvantaged small and rural carriers in many cases renders bill-and-keep proposals more complicated (and less neutral) than existing intercarrier compensation mechanisms. The ICF Plan, for example, distinguishes "covered rural telephone companies" (CRTCs) from other carriers and allows CRTCs to maintain lower residential and single line business Subscriber Line Charge (SLC) caps than non-CRTCs and to follow modified default rules for interconnecting their networks to other carriers.[18] These carve-outs add to the overall complexity of the intercarrier compensation system.[19]

More importantly, the potential simplicity of a mandatory bill-and-keep regime should not take precedence over other goals such as economic efficiency and preservation of universal service. A number of commenters offered evidence refuting the contention that bill-and-keep proposals are more economically efficient than the current system under which calling

---

[17] *See, e.g.*, National Cable & Telecommunications Association (NCTA) Comments at 6 (contending that bill-and-keep will eliminate the need for ongoing governmental involvement in intercarrier compensation matters).

[18] *Id*. at 34-35. *See also* Rural Alliance Comments at 59-62 (discussing the "rural carve outs" of the ICF Plan).

[19] *See, e.g.*, Time Warner Telecom Comments at 6 ("[E]ven [bill-and-keep's] most ardent proponents would likely concede that it represents an enormously complex undertaking.").

party networks pay for the use of other carriers' networks. For example, the Rural Alliance comments include an economic analysis highlighting a number of areas in which mandatory bill-and-keep generates significant economic *inefficiencies*.[20] These include incentives to overuse facilities of terminating carriers; externalities and inefficiencies generated by forcing carriers to price call origination and termination at zero when costs are not zero and traffic exchange is not balanced; costs and administrative complexity generated by the need to move the interconnection points that will define the financial responsibility between carriers; and inadequate investment incentives in high-cost areas. Professor Lehman summarizes the economic efficiency issues thus:

> [Bill and keep] will not generally be efficient except in special circumstances (relatively balanced traffic and cost structures). The best evidence of this is the fact that other industries where inter-firm compensation takes place in an unregulated setting do not generally use bill and keep (Internet backbone services, wireless roaming, financial interchange fees). Bill and keep may serve to promote administrative efficiency, but at the risk of jeopardizing many of the other efficiency measures. Even the administrative efficiency of bill and keep is overstated, due to the fact that it resolves many of today's known administrative problems while creating new problems that we don't yet fully understand (issues associated with defining and monitoring interconnection points).[21]

NASUCA similarly argues that

> Economic efficiency is enhanced by bringing carrier-to-carrier charges closer to cost and requiring carriers that use other carriers' networks to pay charges to recover that cost; in other words, by setting and using a proper price signal. Economic efficiency is **not** enhanced by shifting recovery of costs caused by other telecommunications carriers to end users. . . . Achieving uniformity by dropping [intercarrier compensation] rates to zero

---

[20] *See* Rural Alliance Comments, Appendix B: Dale Lehman, "The Economic Cost of Mandatory Bill and Keep."

[21] *Id*. at 7.

> through mandatory bill and keep creates other incentives which are not economically efficient.[22]

Other commenters share the view that a mandatory bill-and-keep regime would create more economic inefficiencies than efficiencies.[23]

In the Rural Alliance comments, Professor Lehman further notes that competitive factors in the market, apart from the intercarrier compensation regime, provide incentives for minimizing carrier termination costs and thereby obviate the need for regulatory intervention to accomplish that goal.[24] Taken together, these comments significantly undermine the economic efficiency rationale for mandating bill-and-keep for all carriers, including in circumstances where cost structures differ and traffic flows are imbalanced. Commenters also note that because a mandatory bill-and-keep regime will transfer network costs from other carriers to end users, it could impose additional and unnecessary burdens on the universal service system, thereby undermining the Commission's goal of preserving universal service.[25]

C. A Mandatory Bill-and-Keep System Would Not Promote Competitive and Technological Neutrality

Wireless carriers contend that a mandatory bill-and-keep regime would promote the Commission's goal of competitive neutrality in intercarrier compensation, but they fail to recognize that competitive neutrality does not always require that all carriers be treated precisely

---

[22] NASUCA Comments at 22-23 (emphasis in original); *see also* NASUCA Comments, Attachment 4, Affidavit of David J. Gabel (providing a detailed discussion of economic inefficiencies generated by a mandatory bill-and-keep regime).

[23] *See, e.g.*, BellSouth Comments at 10-12; CenturyTel Comments at 16-18; Wyoming Office of Consumer Advocate Comments at 8-9; CTA Comments at 7.

[24] *See* Rural Alliance Comments, App. B. at 2.

[25] *See, e.g.* Rural Alliance Comments at 87-88; South Dakota Public Utilities Commission at 5-6; Iowa Utilities Board at 5; *see also* The Expanded Portland Group, A Comprehensive Plan for Intercarrier Compensation Reform, at 12 (Nov. 2, 2004).

the same, where market and regulatory distinctions justify disparate treatment.[26] For example, CTIA claims that eliminating access charges by mandating bill-and-keep would create a "level playing field" because IXCs do not currently pay access charges to wireless carriers.[27] But key differences between wireless and wireline business models and regulatory obligations belie the contention that the carriers must receive identical intercarrier compensation to achieve competitive neutrality.

Wireless carriers typically face few if any of the regulatory obligations imposed on wireline local exchange carriers (LECs), starting with a complete lack of state entry and rate regulation. Even wireless carriers designated as eligible telecommunications carriers (ETCs) typically are not subject to carrier-of-last-resort obligations and thus have greater freedom to limit their service to areas that yield an adequate return on investment. In addition, wireless carriers years ago lobbied successfully to abandon any equal access obligations requiring carriers to allow end user customers to choose their preferred IXC. This means that wireless carriers necessarily own the retail relationship with – and retain the revenue from – customers placing long distance as well as local telephone calls.

Finally, the wireless business model, which has long been based on end user customers' paying for all calls (both initiated and received), has not traditionally relied on intercarrier payments to recover network costs. Charging customers for all calls, coming and going, profoundly distinguishes the economics of the wireless industry from those of the wireline industry. For all these reasons, a mandatory bill-and-keep regime is not necessary to ensure

---

[26] As Victor Hugo observed, one of the great inequities in life is to treat unequal people equally.

[27] CTIA Comments at 14-15. CTIA argues that LECs therefore subsidize local competition with wireless carriers relying upon a revenue source largely denied to wireless carriers.

competitive neutrality between wireline and wireless carriers with respect to intercarrier compensation.

In sum, commenters proposing mandatory bill-and-keep regimes have not demonstrated that their proposals advance the Commission's goals for intercarrier compensation reform or otherwise serve the public interest. To the contrary, a mandatory bill-and-keep regime would in many cases undermine the Commission's specific goals for this proceeding. In addition, depriving carriers of intercarrier compensation revenues and forcing them to recover all network costs from their end users would undermine the Commission's overarching policy goal of promoting universal deployment of advanced telecommunications services, including broadband.[28] Denying carriers a significant revenue stream would dramatically reduce carriers' ability to invest in deployment of broadband services, while higher end user rates for basic telecommunications services would reduce the resources consumers have available to subscribe to those broadband services that are available.

III. TARGETED, NARROW REFORMS OFFER THE BEST SOLUTION TO REFORMING INTERCARRIER COMPENSATION

Although radical reform of the intercarrier compensation system is not justified on the current record, immediate steps can be taken to improve the efficiency and transparency of the system without radically altering the allocation of network costs or dramatically increasing end user charges. Specifically, the Commission can take steps now (1) to correct the problem of "phantom traffic" delivered with inadequate information to permit accurate billing and collection; (2) to resolve outstanding questions concerning carrier transiting obligations, including with respect to traffic delivered to Internet service providers (ISPs); (3) to define

[28] For competitive carriers, the rate increases that would be necessary to sustain infrastructure investment may not even be possible without losing customers and becoming uncompetitive in the market.

financial responsibility for transport of Virtual NXX calls; (4) to clarify that the enhanced service provider (ESP) exemption does not apply, and thus that applicable intercarrier charges are payable, for IP-based calls that terminate on the public switched network; and (5) to eliminate the intraMTA rule.

Phantom Traffic. In their initial comments, TDS and other rural carriers who depend on intercarrier compensation as a significant revenue source highlighted the importance of fixing the phantom traffic problem to ensure that all carriers participate fairly in the intercarrier compensation system and that the market functions efficiently and effectively.[29] There is little dispute in the initial comments that phantom traffic is a serious problem.[30] Moreover, commenters have proposed a number of reasonable and relatively simple measures

[29] *See*, e.g., CenturyTel Comments at 5-7 ("'Phantom traffic' is one of the fastest growing problems facing the industry."); Iowa Telecommunications Association Comments at 3 ("A rural LEC should not be required to terminate traffic for which it cannot receive compensation."); NTCA Comments at 51 (Commission should adopt rules for identifying and billing phantom traffic); TCA, Inc. Comments at 3-4 (current intercarrier compensation rules must be enforced to address phantom traffic).

[30] Verizon Wireless contends that rural carriers have not provided proof that phantom traffic exists and that, to the extent it is a problem, it is a result of the current intercarrier compensation system under which the calling party network pays. Verizon Wireless Comments at 6. These comments fly in the face of widespread industry acknowledgement that phantom traffic is a real and growing problem. For instance, the National Exchange Carrier Association (NECA) held a full-day conference in April 2004 devoted entirely to the phantom traffic problem. The conference included a range of industry speakers including, among others, speakers from CTIA and Verizon. Verizon recognized that phantom traffic is a "growing concern" and has potential impacts on "revenue leakage" and "inflated expense levels." *See* Verizon, *Phantom Traffic 2004, Scope of the Problem* (Apr. 7, 2004) at 2 (available at http://www.neca.org/media/Jonathan_Smith.pdf). Evidence of the problem submitted in this proceeding includes documentation in the Expanded Portland Group (EPG) proposal showing that up to twenty percent of traffic transiting some RLEC networks over common trunk groups is phantom traffic, *see* EPG Plan at 5, as well as an *ex parte* presentation made recently by a group of mid-sized companies providing evidence of the phantom traffic problem. *Ex Parte* Letter from Karen Brinkmann, on behalf of Mid-Sized Companies, to Marlene Dortch, Secretary, FCC, CC Docket No. 01-92 (July 1, 2005) (Mid-Sized Company *Ex Parte*) (attaching Balhoff & Rowe, LLC, *Phantom Traffic: Problem and Solutions* (May 2005), showing up to 20-30% of minutes as phantom traffic). Although the elimination of most intercarrier compensation through adoption of a mandatory bill-and-keep system would reduce the need to address the phantom traffic issue, the many failings of mandatory bill-and-keep, as described in Part II above, make it an unworkable alternative that cannot be cited to dismiss the problem of phantom traffic.

that the Commission can adopt to remedy this problem.[31] Thus, the record is ripe and TDS urges the Commission to take action in this regard.

TDS supports the adoption of measures similar to those proposed by the Expanded Portland Group (EPG), including, at a minimum, (1) “truth-in-billing” guidelines that make it explicitly unlawful to alter, exclude, or strip carrier and call identifying information; (2) processes for challenging suspect traffic and penalizing responsible carriers; (3) after a transition period, rules permitting inaccurately labeled traffic to be billed at the highest applicable rate to the carrier delivering the traffic; and (4) rules authorizing the blocking of inaccurately labeled traffic (again after a transition period).[32] As described by consultants Balhoff & Rowe, “[m]eaningful reform will require strong action by [the Commission] on two issues”: “[c]lear and forceful regulations to label traffic [and] enforcement rules that deter offenses.”[33]

Transiting Obligations. The Commission should also act now to clarify carrier transiting obligations, particularly with respect to ISP-bound traffic. These obligations will need to be analyzed in the context of any overall intercarrier compensation reform because third-party transiting may play a role in the interconnection regime and unanticipated transiting costs could affect investment incentives and end-user costs.[34] More immediately, independent LECs and competitive local exchange carriers (CLECs) today are facing growing transiting costs imposed

---

[31] *See, e.g.*, NTCA Comments at 51-54 (proposing consideration of new alternatives for identifying future traffic); Mid-Sized Company *Ex Parte*.

[32] EPG Plan at 2, 16-17.

[33] Mid-Sized Company *Ex Parte* at 6.

[34] For example, efforts to impose intercarrier compensation reforms will be undermined if large ILECs are able to charge excessive rates for transiting services.

on all traffic, including ISP-bound traffic.[35] There is a need for the Commission to clarify the scope of carrier obligations to transit inter-network traffic at reasonable rates.

As an initial step, the Commission should clarify that Sections 201 and 202 require LECs that exercise significant market power over transiting services to offer such services at rates that are "just and reasonable" and not unreasonably or unjustly discriminatory.[36] Regional Bell Operating Companies (RBOCs) should be presumed to exercise such market power in their service areas in the absence of a showing of effective competition from alternative sources. Although some RBOCs contend that transiting services are readily available from multiple sources,[37] these claims are not well-supported and are not consistent with TDS's experience. In many cases, independent carriers like TDS have no commercially viable alternative to deliver traffic to indirectly interconnecting carriers other than through transit services obtained from the nearby RBOC. Although independent transit providers are beginning to enter the market in limited geographic areas, these services are far from ubiquitous.[38] Moreover, in the near term it is more likely that consolidation from pending mergers will reduce the availability of inter-network transport options.[39]

---

[35] The transiting issue is particularly problematic in the context of Virtual NXX arrangements in which CLECs assign local numbers to an ISP but switch and terminate the traffic in another market. Where an intervening ILEC assesses high transit costs, the arbitrage created by the imbalance of ISP-bound traffic is exacerbated and the local LEC is unfairly burdened with unduly high costs to serve a few local numbers.

[36] 47 U.S.C. §§ 201(b), 202(a).

[37] BellSouth asserts that carriers are able to obtain transiting services at reasonable rates, and claims that BellSouth and other LECs have voluntary agreements to provide transit services and will continue to be able to negotiate such agreements. BellSouth Comments at 36-38.

[38] *See* www.neutraltandem.com (stating that Neutral Tandem is "the industry's only independent tandem service provider," with operational switching facilities in Los Angeles, Minneapolis, Milwaukee, Chicago, Detroit, Cleveland, Columbus, OH, New York City, Connecticut, and Miami).

[39] *See* Rural Alliance Comments at 13; *see also* SBC-AT&T Merger Application, WC Docket No. 05-65 (pending), Verizon-MCI Merger Application, WC Docket No. 05-75 (pending).

BellSouth denies that RBOCs exercise market power with respect to transiting and thus argues that transit services should not be subject to regulation under Section 201. However, BellSouth is alone among the RBOCs in taking the definitive position that Section 201 does not "provide a plausible basis to regulate transiting services."[40] By contrast, Qwest expressly acknowledges that "[t]ransiting is an interconnection service subject to Sections 201 and 202 of the Act."[41] As noted above, RBOCs exercise significant control over transiting arrangements and should be required to provide such services at reasonable rates and on a non-discriminatory basis.[42] TDS agrees with CLEC commenters that "[t]o find that there is no obligation of the ILEC to provide tandem transit would permit the ILEC to exercise its market power over . . . interconnection [between CLECs and ILECs], to the detriment of the CLEC and policy goals overall."[43]

The Commission should also address the specific issue of transiting charges for traffic delivered to an Internet service provider (ISP-bound traffic). The *ISP Remand Order* recognized the imbalanced exchange of ISP-bound traffic and the market distortion that occurs

---

[40] BellSouth Comments at 36. Verizon asserts that the Commission's legal authority to adopt comprehensive intercarrier compensation reform is uncertain but favors negotiated commercial agreements instead of Commission regulation. Verizon Comments at 2, 33. Cincinnati Bell states that there is "no direct answer [to the Commission's question whether there is a legal obligation to provide transiting] in the Act." Cincinnati Bell Comments at 15-16. SBC claims that carriers are not obligated to provide transiting under Section 251(c) of the Act but notes that "the Commission has limited jurisdiction under section 201 of the Act to prevent carriers from *disrupting* indirect interconnection once carriers are relying on it." SBC Comments at 4 n.2.

[41] Qwest Comments at 36.

[42] Rural Alliance Comments at 13, 120-25.

[43] Pac-West Telecomm *et al*. (Pac-West) Comments at 22. Pac-West also notes that numerous state commissions have ruled that ILECs have an obligation to providing transiting services. *Id*. at 22-23. *See also* CenturyTel Comments at 43 ("[T]he Commission should clarify whether every carrier has an obligation to permit other carriers to transit its network … If transiting is not a right of all telecommunications carriers, and an obligation of all carriers, then the ability to provide ubiquitous service will be undermined, and the national 'network of networks' may revert to one or two large network operators with market power, and a variety of small, non-interconnected networks with limited service, that characterized the U.S. telephone system of the early 1900s.").

when originating carriers are required to pay compensation for transport and termination of ISP-bound traffic.[44] The interim compensation regime for ISP-bound traffic thus called for significantly reduced rates for ISP-bound traffic to minimize the unfairness and inefficiency of this exchange.[45] This interim compensation regime is (and any permanent regime will be) significantly undermined when intermediate carriers attempt to charge high transiting rates for the delivery of ISP-bound traffic from independent ILECs to CLECs serving ISPs.[46]

The RBOCs themselves recognize that ISP-bound traffic is interstate and within the Commission's Section 201 jurisdiction[47] and that requiring payment for transport of Virtual NXX and other ISP-bound traffic imposes unfair burdens on ILECs.[48] The Commission should exercise its jurisdiction now to address the question of what type of compensation is appropriate for transiting ISP-bound traffic.[49] At a minimum, the Commission should ensure that *neither* local carriers terminating large amounts of traffic to ISP customers, nor the intermediate carriers that deliver traffic between originating and terminating LECs, benefit unfairly from inefficient network usage patterns. We recommend that the Commission prohibit the assessment of transiting charges for ISP-bound traffic or, at most, cap the total charges that can be assessed for

---

[44] Order on Remand and Report and Order, *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996; Intercarrier Compensation for ISP-Bound Traffic*, 16 FCC Rcd 9151 ¶¶ 2, 5, 21 (*ISP Remand Order*), *remanded but not vacated by* WorldCom, Inc. v. FCC, 288 F.3d 429 (D.C. Cir. 2002), *cert. denied*, 123 S. Ct. 1927 (2003).

[45] *ISP Remand Order* ¶¶ 8, 77-89.

[46] As noted above, these charges have become particularly problematic in Virtual NXX arrangements. In addition, the attempts by some carriers to assess transit charges for ISP-bound traffic pursuant to state tariffs (despite the clear precedent identifying ISP-bound traffic as interstate) has undermined the Commission's ability to review such charges for their effect on the interim compensation regime for ISP-bound traffic.

[47] *See* Verizon Comments, Attachment B, at 25

[48] *Id*. at 41.

[49] The Commission recognized in the *ISP Remand Order* that "[a] number of questions must be resolved … [including] the allocation of transport costs between interconnecting carriers." *ISP Remand Order* at n. 145.

transport *and* termination of ISP-bound traffic at the $.0007 per minute of use rate established in the *ISP Remand Order*.

Virtual NXX Traffic. The problem of high transit costs for the inter-network transport of ISP-bound traffic could be avoided in part if the Commission more clearly defined financial responsibility for the delivery of Virtual NXX traffic, where a CLEC assigns a dial-up number to an ISP in one local market but switches and terminates the traffic to the ISP customer in another market. Where the CLEC has made the determination to switch and terminate traffic from a local number outside the local market, the CLEC should be responsible for the inter-network transport costs for delivering the traffic to the out-of-market switch.[50]

Terminating IP-based Calls to the Public Switched Network. The Commission should also affirm that the enhanced service provider (ESP) exemption does not apply to ISPs that terminate Internet Protocol (IP)-based voice traffic to the public switched telephone network. As the Rural Alliance notes, the ESP exemption was not intended to allow ISPs to terminate intercarrier voice traffic for free over a LEC's local network. TDS accepts that the exemption should continue to apply to permit the provision of dial-up information services by an ISP, but TDS agrees with the Rural Alliance that access charges should apply to all voice traffic terminated from an IXC via an ISP to the public switched network, regardless of whether the ISP is directly or indirectly connected to the LEC network.[51]

IntraMTA Rule. Finally, we urge the Commission to take an important step toward unified intercarrier compensation by eliminating the intraMTA rule. Under the

---

[50] *See, e.g.*, California Small LEC Comments at 2-5 (proposing that Virtual NXX traffic be subject to intercarrier compensation based on the geographic routing points for the traffic as specified in the LERG, rather than on the basis of artificially assigned rating points).

[51] Rural Alliance Comments at 162, 160 n.334.

intraMTA rule, traffic delivered to or from a CMRS network that originates and terminates within the same Major Trading Area (MTA) is subject to reciprocal compensation rather than interstate or intrastate access charges, even where the traffic is delivered to or received from a point outside the originating or terminating LEC's network. TDS concurs with the Rural Alliance that the intraMTA rule creates both artificial distinctions between calls and confusion among carriers and regulators. In addition, it results in an inconsistent application of reciprocal compensation and access charges.[52] For example, calls from a wireline customer that are delivered to an IXC and would otherwise result in the payment of access charges from the IXC to the originating LEC instead result, because they terminate to a CMRS customer within the MTA, in the payment of reciprocal compensation by the originating LEC to the CMRS provider. As noted by the Rural Alliance, "[t]he environment created by the intraMTA rule is incompatible with the Commission's goal of moving toward a more unified regime."[53] In lieu of the intraMTA rule, reciprocal compensation should apply where a LEC-CMRS call originates and terminates, and is routed through a point of interconnection (POI) within, a single local exchange. Any LEC-CMRS call routed through an IXC should be subject to access charges.[54] *Id*.

IV. ANY MODIFIED INTERCARRIER COMPENSATION SYSTEM MUST PRESERVE ADEQUATE INVESTMENT INCENTIVES TO ENSURE COMPARABLE SERVICES AND RATES IN URBAN AND RURAL AREAS

To the extent that the Commission pursues more fundamental intercarrier compensation reform at this time, TDS supports the collaborative approach set forth in the comments and reply comments of the Rural Alliance. Specifically, TDS urges the Commission

[52] Rural Alliance Comments at 126-130.
[53] Rural Alliance Comments at 127.
[54] Rural Alliance Comments at 127-30.

to ensure that any new intercarrier compensation regime meets the following requirements: (1) establish a system that enables each carrier to transition towards a unified rate for all traffic, while allowing rates to vary between carriers based on differences in their underlying cost structures; (2) preserve compensation for originating and terminating calls; and (3) include mechanisms to preserve carriers' incentives to invest in evolving telecommunications services, consistent with the goal of maintaining comparable services and rates between urban and rural areas.

First, the Commission can minimize regulatory arbitrage opportunities by establishing a system under which each carrier can transition to a uniform rate for all categories of traffic.[55] The most significant gains in promoting simplicity and minimizing arbitrage opportunities result from eliminating distinctions between types of traffic. This will achieve the simplicity goals endorsed by the proponents of mandatory bill-and-keep while at the same time ensuring that carriers are able to recover some revenue when other carriers use their networks.

By contrast, there is little to be gained in terms of simplicity – and much to be lost in terms of network investment, economically rational pricing, and service quality – if all carriers are forced to charge the same unified rate regardless of underlying costs.[56] As the economist testimony submitted with the Rural Alliance and NASUCA comments attests, economically rational pricing requires that intercarrier compensation rates have some basis in the underlying

---

[55] *See* Rural Alliance Comments at 12.

[56] BellSouth and others argue that intercarrier compensation rates that vary from company to company are inconsistent with the Commission's goal of replacing the existing intercarrier compensation system with a "unified" approach. BellSouth Comments at 14-16. This argument confusing unification of rates across a company with unification across the industry.

cost structure of the providing carrier.[57] It is widely understood that carriers serving different geographic areas face dramatically different costs to provide consumers with connectivity to the telecommunications network. Accordingly, an economically efficient intercarrier compensation system must have the ability to reflect those cost differences in the rates charged by individual carriers (both incumbents and competitors). As long as each carrier moves toward a unified rate for all calls on its network, the opportunities for regulatory arbitrage between services and categories of carrier will be minimized *and* the rates charged for intercarrier compensation will send appropriate economic signals based on the costs of providing service.[58]

Second, compensation for both originating and terminating use of local networks should be preserved. Any call traveling over a local provider's network imposes costs,[59] and those costs should be absorbed (or passed on to the customer) by the carrier with the retail relationship with the customer initiating the call.[60] Because the long distance carrier owns the retail relationship with the customer initiating a long distance call, as compared to the direct retail relationship that exists between the party initiating a local call and the local service provider, it remains appropriate to preserve the distinction between access charges and reciprocal compensation. This distinction (particularly the assessment of originating access for long

---

[57] *See* Rural Alliance Comments, Appendix B: Dale Lehman, "The Economic Cost of Mandatory Bill and Keep;" NASUCA Comments, Attachment 4, Affidavit of David J. Gabel.

[58] *See* TDS Comments at 23. For ILECs, TDS supports the Rural Alliance's endorsement of the use of embedded costs, plus an allocation of joint and common costs. *See* Rural Alliance Comments at 34-41.

[59] *See, e.g.*, NASUCA Comments, Attachment 4 at 12-35 (describing traffic-sensitive nature of digital switching costs); *see also supra* note 3.

[60] *See, e.g.*, Rural Alliance Comments at 94-95; Pac-West Comments at 30.

distance, but not local, calls) should be maintained even though the rates charged for each type of traffic could be the same.[61]

Third, any intercarrier compensation reform that reduces access charges must include mechanisms to ensure that rural telephone companies and competitive carriers experiencing a material decline in access revenues continue to recover sufficient revenues from intercarrier or other sources to preserve investment in rural and suburban communities. Rural and competitive telephone companies offer great promise for advancing the Commission's priority goal of promoting broadband deployment nationwide.[62] But the carriers' ability to fulfill that promise depends on some level of revenue assurance, particularly in rural markets where reasonable subscriber fees alone would provide insufficient revenue to permit investment in telecommunications infrastructure. Over a quarter of TDS's ILEC and CLEC revenues currently come from intercarrier compensation, figures that are typical of many carriers serving smaller markets.[63] TDS and other rural and suburban carriers could not withstand the elimination of a significant portion of those revenues while continuing to maintain reasonable and competitive rates and to invest in network infrastructure and the deployment of advanced technologies. Accordingly, the necessary access revenue replacement mechanisms (available to both incumbents and competitors that can demonstrate a material decline in access revenues) must be in place before the Commission implements any intercarrier compensation reforms that reduce access charge revenues.[64]

---

[61] *See* Rural Alliance Comments at 13; TDS Comments at 18-19.

[62] *See supra* note 1.

[63] *See* TDS Comments at 26.

[64] In any event, any new support mechanisms should only go to those impacted by intercarrier compensation reforms. *See, e.g.*, CenturyTel Comments at 37.

The revenue replacement mechanism the Commission adopts need not preserve artificially low rural service rates, as some commenters have charged.[65] The EPG and others have proposed bulk-billed access charge revenue replacement mechanisms that are available only to carriers that charge local service rates at or above a specified national benchmark (based on urban rates).[66] Carriers with local rates below the national benchmark could be required to recover a portion of their lost access revenues from end-users through a Variable Federal Optional SLC increase (which could be implemented quickly without the need for intervening regulatory action).[67] Once the SLC increases brought the carrier's rates up to the national benchmark, the carrier would be entitled to take advantage of the revenue recovery mechanism. This approach is consistent with the statutory requirement that rural rates be comparable to those in urban areas.[68]

Although several parties suggest that lost access revenues should be recovered either from end users or, in some cases, a universal service support mechanism,[69] neither approach is satisfactory. Shifting all lost access charges to end-users would result in dramatic increases in local rates and, ultimately, rural service rates that are not comparable to those for

---

[65] *See, e.g.*, CTIA Comments at 39-40.

[66] *See, e.g.*, the EPG Plan's Access Restructure Charge (ARC) and the PBT/Home Telephone Company Plan's High Cost Connection Fund (HCCF); *see also* Coalition for Capacity-Based Access Pricing Comments at 20 (supporting bulk-billed HCCF); NTCA Comments at 55 (new rural cost recovery mechanism would not be universal service); Cincinnati Bell Comments at 11 (Commission should allow an alternative mechanism to replace revenue); Comporium Comments at 11 (supporting ARC or HCCF); Frontier Comments at 11 (opposing increase in SLCs or end-user rates); NASUCA Comments at 30 ("NASUCA adamantly opposes an increase in the SLC as part of any ICC reform plan."). *See* Rural Alliance Comments at 79-81 for guidelines on determining an appropriate national benchmark.

[67] *See* EPG Plan at 4, 25-26.

[68] *See* 47 U.S.C. § 254(b)(3).

[69] *See, e.g.*, ICF Comments at 31-33; CTIA Comments at 31-40; SBC Comments at 24-31. Other supporters of bill-and-keep plans would not provide additional USF mechanisms, thus failing in any way to permit RLECs to support their networks other than by raising end-user rates. *See, e.g.*, Qwest Comments at 17-18.

comparable services in urban areas. Relying on universal service support to replace a substantial portion of lost access charges would (1) place significant additional burdens on an already strained USF, (2) inefficiently allocate costs to sources that may not bear any responsibility for the incursion of those costs, and (3) inefficiently allocate revenue replacement to carriers that may not have lost any intercarrier compensation revenue. For example, wireless CETCs serving areas served by a rate-of-return ILEC currently receive Interstate Common Line Support from USF even though that mechanism was created to replace revenue lost as a result of the *MAG Order*,[70] which did not apply to wireless carriers. At the same time, CLECs that are affected by intercarrier compensation changes would be left with no means of restoring lost revenues except by seeking CETC designation (with its attendance commitments and responsibilities) or raising end-user rates. Excluding CLECs whose access revenues are affected by intercarrier compensation reform from the revenue replacement mechanism would not be competitively neutral and could undermine competition in the local telecommunications service market.

V. COMMENTERS HAVE NOT DEMONSTRATED A NEED TO MODIFY EXISTING INTERCONNECTION ARRANGEMENTS

Commenters supporting bill-and-keep proposals have also advocated changes in network interconnection obligations, including new requirements for carriers to interconnect at multiple "edges" within a LATA. As noted in the economic analysis accompanying the Rural Alliance comments, however, attempting to modify interconnection arrangements to accommodate a bill-and-keep intercarrier compensation regime could create far more administrative complexity than the bill-and-keep system would eliminate:

---

[70] *See* Fifteenth Report and Order, *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, 16 FCC Rcd 19613 (2001) (*MAG Order*).

> Bill and keep replaces the known monitoring and billing problems associated with access charges with the relatively unknown tasks associated with interconnection points. Definition of interconnection points is critical to bill and keep and traffic will still need to be monitored in order to ensure that the interconnection points are chosen correctly. It may be harder to move interconnection points than to change the level of access charges since facility investments are likely to be sunk once the points are defined. As technologies evolve, the meaning of interconnection points may change. For example, mesh wireless networks may not easily fit with definition of some interconnection points. So, bill and keep's apparent administrative efficiency, in part, results from the fact that we have limited experience with defining interconnection points.[71]

In addition, imposing new interconnection requirements could result in expensive re-routing of traffic and the payment of significant transiting costs to large ILECs. This could, in the absence of adequate revenue replacement mechanisms, result in even higher price hikes for consumers.

Accordingly, TDS urges the Commission, in addition to retaining the overall structure of intercarrier compensation that exists today, to preserve existing interconnection obligations. Rural LECs (RLECs) should continue to recover compensation based on interconnection at a negotiated meet point on the RLEC's network for each contiguous group of RLEC local exchanges within a LATA.[72] For all other carriers, including CLECs, the default network interconnection arrangement should be a single point of interconnection ("single POI") on an ILEC's network within each LATA. The single POI would be a default only and could be replaced by a different network arrangement upon mutual agreement of the interconnecting parties.[73]

---

[71] Rural Alliance Comments, Att. B at 5-6 (internal footnote omitted).

[72] *See* TDS Comments at 28-29.

[73] *Id*.

CONCLUSION

In accordance with the foregoing, TDS recommends that the Commission take a targeted, measured approach to intercarrier compensation reform at this time. Immediate priorities should include minimizing "phantom traffic," clarifying carrier transiting obligations and financial responsibility for transiting Virtual NXX traffic, affirming compensation obligations for IP-based voice calls terminating on the public network, and eliminating the intraMTA rule. Any intercarrier compensation reform the Commission adopts should (1) not include mandatory bill-and-keep; (2) permit carriers to transition to unified rates for all traffic while allowing rates between carriers to vary based on underlying cost structures; (3) preserve compensation for originating and terminating calls; and (4) include mechanisms to preserve carriers' investment incentives, consistent with maintaining comparable services and rates between urban and rural areas. There is no need for the Commission fundamentally to alter existing interconnection arrangements.

Following these recommendations and principles will promote the public interest by remedying immediate and specific problems with the intercarrier compensation system and ensuring that carriers throughout the country continue to have the financial wherewithal to provide high-quality, advanced telecommunications services connecting consumers nationwide.

Respectfully submitted,

Gerard J. Waldron
Mary Newcomer Williams
Darrin Hurwitz
COVINGTON & BURLING
1201 Pennsylvania Avenue, N.W.
Washington, D.C. 20004-2401
Tel.: (202) 662-6000
Fax: (202) 662-6291

Kathleen Wallman
KATHLEEN WALLMAN, PLLC
9332 Ramey Lane
Great Falls, VA 22066

Counsel to TDS Telecommunications Corp.

July 20, 2005